

Microsoft MSFT Investment Notes

Please read Disclaimer at bottom of these notes!

“Founded in 1975 in Redmond, Washington, Microsoft is the world's largest software company. The company provides a vast range of software products and services for computing devices for both consumer and business use. These products and services include operating systems for servers, personal computers, and intelligent devices; server applications for distributed computing environments; information worker productivity applications; business solutions applications; high-performance computing applications; software development tools; and video games through its Xbox franchise.” **Wells Fargo 4/28/11**

May 25, 2011 (24.26) Review of VL 5/20/11

Really nothing new discussed. They mention the possibility of Wall Street not liking MSFT could be a blessing for the stock itself. Mentions Skype might bring them into a better place. Also stresses that mobility solutions need to grow and excel.

Some Projections from VL

	F2011	F2012
Revenues per Share	8.35	9.30
Cash Flow	3.00	3.25
EPS	2.6	2.8
Dividends	.64	.76
Capex	.30	.30
Book Value	6.60	7.90
Tangible Book Value	5.20	6.50
Common Shares O/S	8350	8000
Tax Rate	21.0%	24.0%
ROE	40.5%	36.5%
ROTC	33.5%	31.0%
Div Payout Ratio	24%	27%

April 29, 2011 (25.45) Some Analysis and Thesis

Increased positions to 7.50% (where risk and cash available tolerated) today at \$25.65. MSFT is clearly our largest equity position at this point. Annual ROI's even using a lower than anticipated growth rate is still high teens over 15 year period.

1. Immaculate balance sheet.
2. Lots of cash.
3. I think in time, the potential exists that Ballmer will be praised for his fiscal patience.
4. FCF and earnings are both of high quality, and I believe both to be stable at a minimum. Compare that to the price you pay, and I like the yield.
5. I don't see them being replaced in enterprise.
6. Nice dividend, but that can be combined with FCF discussion.
7. Trying to "kill this investment," and I can't. I just don't see the degradation of the company that so many others see.

Company Name	Microsoft
Symbol	MSFT
Date Worked On	29-Apr-11
Base Year	30-Jun-11
Price	\$25.60
Shares Outstanding	8,510
Market Capitalization	\$217,856
Cash and CE	\$50,150
Long Term Debt	\$11,915
Minority Interests	\$0

Goodwill	\$12,554
Intangibles	\$840
Other Intangibles	\$0
Enterprise Value	\$179,621
Short Term Debt	\$0
Stockholders Equity	\$53,452
Depreciation and Amortization	\$2,800
CapEx	\$2,600
Revenues	\$69,000
Total Assets	\$99,727
Net Income	\$22,500
Dividend	\$0.64
Interest Expense	\$300
Net Income Before Taxes	\$27,500
Enterprise Value Per Share	\$21.11
Price To Enterprise Value	121.29%
Total Debt	\$11,915
Total Debt / Net Income	52.96%
Total Debt Per Share	\$1.40
Tangible Book Value	\$40,058
Book Value Per Share	\$6.28
Tangible Book Value Per Share	\$4.71

Price / Book Value	407.57%
Price / Tangible Book Value	543.85%
Price / Earnings Ratio	9.68
Enterprise Value / Earnings Ratio	7.98
Earnings Yield	10.33%
Price To Sales Ratio	315.73%
Net Income / Total Assets	22.56%
Total Assets / (Revenues/365)	527.54
Enterprise Value / Revenues	260.32%
Goodwill / Total Assets	12.59%
Goodwill / Stockholders Equity	23.49%
Debt / Equity	22.29%
Average P/E Last 10 Years	18.0
Cash Flow	\$22,700
Cash Flow Per Share	2.67
Cash Flow Yield	10.42%
Price / Cash Flow	9.60
Revenues Per Share	\$8.11
Net Income Per Share	\$2.64
Return on Equity	42.09%
Bond Rating (S&P)	AAA
Growth Rate	8.00%
Dividend Yield	2.50%
Dividend / Net Income	24.21%

Dividend / Cash Flow	23.99%
Interest Coverage Ratio	92.67
Insider Activity	Selling
Buy-Backs	Yes
Dilution	No
Management Compensation	Fair
Price to buy more	\$26.00
Price to sell or consider reducing	\$60.00
Action (Buy, Hold or Sell)	Buy
Portfolio Allocation Suggestion	7.50%

Microsoft	MSFT
As of Date	March 31, 2011
EV Analysis	
	April 29, 2011
Share Outstanding	8,510.00
Share Price	\$25.50
Market Capitalization	\$217,005.00
Less: Cash and Short Term Investments	(\$50,150.00)
Add: Long Term Debt	\$11,915.00
Minority Interest	\$0.00
Enterprise Value	\$178,770.00

EV per share	\$21.01
Stockholders' Equity	\$53,452.00
Adjustments:	
Goodwill	(\$12,554.00)
Tradenames	\$0.00
Other Intangibles	(\$840.00)
Net Stockholders' Equity	\$40,058.00
Adjusted Book Value per Share	\$4.71

Quick Projections 2011	April 29, 2011
Revenue	\$69,000.00
Net Margin % before tax	43.00%
Net Margin before taxes	\$29,670.00
Tax Rate	25.00%
Corporate Taxes	\$7,417.50
Net Income after Taxes	\$22,252.50
Net Margin %	32.25%
Shares Outstanding	8,510.00
eps	\$2.61

FV of current equity and future earnings	29-Apr-11	29-Apr-11
Adjusted Stockholder's Equity	\$40,058.00	\$40,058.00
Net Profit	\$22,252.50	\$22,252.50
Growth Rate of Net Profit for 10N	5.00%	7.00%
Growth Rate of Net Profit after 10N through 15N	3.00%	2.00%
FV of Net Profit in 10N	\$36,246.98	\$43,774.04
FV of Net Profit in 15N	\$42,020.18	\$48,330.07
FV of tangible book value plus Net Profits for 10N	\$345,139.81	\$386,250.66
FV of tangible book value plus Net Profits for years 11 - 15N	\$592,551.77	\$654,253.78
Current Enterprise Value	\$178,770.00	\$178,770.00
FV of tangible book value plus Net Profits for 10N	(\$345,139.81)	(\$386,250.66)
Years	10	10
ROI on tangible book value plus Net Profits for 10N	6.80%	8.01%
FV of tangible book value plus Net Profits for 10N	\$345,139.81	\$386,250.66
FV of tangible book value multiplier	3.00	3.00
FV of Tangible Book Value using BV multiplier in year 10	\$1,035,419.44	\$1,158,751.97
Current Enterprise Value	\$178,770.00	\$178,770.00
FV of tangible book value plus Net Profits for years 11 - 15N	(\$592,551.77)	(\$654,253.78)
Years	15	15
ROI on tangible book value plus Net Profits for 15N	8.32%	9.03%
FV of tangible book value plus Net Profits for 15N	\$592,551.77	\$654,253.78
FV of tangible book value multiplier	3.00	3.00
FV of Tangible Book Value using BV multiplier in year 15	\$1,777,655.30	\$1,962,761.33
Potential Future EV using BV multiplier above		
Current Enterprise Value	\$178,770.00	\$178,770.00
FV of Tangible Book Value using BV multiplier in year 10	(\$1,035,419.44)	(\$1,158,751.97)
Years	10	10
ROI on FV of Tangible Book Value using BV multiplier in year 10	19.20%	20.55%
Current Enterprise Value	\$178,770.00	\$178,770.00
FV of Tangible Book Value using BV multiplier in year 15	(\$1,777,655.30)	(\$1,962,761.33)
Years	15	15
ROI on FV of Tangible Book Value using BV multiplier in year 15	16.55%	17.32%

Sanity Checks:		
P/E in future		
FV of Net Profit in 15N	\$42,020	\$48,330
P/E estimate	15.00	15.00
Market Cap on above	-\$630,303	-\$724,951
Years	15	15
Current Enterprise Value	\$178,770	\$178,770
ROI in 15N using above	8.76%	9.78%
Potential Revenue Growth		
Current Revenues	\$69,000	\$69,000
Growth Rate of Revenues for 10N	5.00%	7.00%
Growth Rate of Revenues after 10N through 15N	3.00%	2.00%
FV of Revenues in 10N	(\$112,394)	(\$135,733)
FV of Revenues in 15N	\$130,295	\$149,861
FV of Revenues in 15N	\$130,295	\$149,861
Revenue Multiplier based on Al Meyer Rule of Thumb net margins	5	5
Possible Market Cap year 15	(\$651,476)	(\$749,303)
Years	15	15
Current Enterprise Value	\$178,770	\$178,770
ROI in 15N using above	9%	10%

	3 months ending	3 months ending
	31-Mar-11	30-Sep-10
Net Income	\$5,232	\$5,410
Add Back:		
Depreciation and Amortization	\$720	\$694
Gains on Derivatives	\$122	(\$29)
Deferral of Unearned Revenue	\$6,616	\$5,881
Recognition of Unearned Revenue	(\$7,026)	(\$6,862)

Adjusted Cash Flow from Operations	\$5,664	\$5,094
Debt Repayments	\$0	(\$814)
Common Stock Repurchased	(\$848)	(\$4,399)
Common Stock Issued	\$1,405	\$177
Common Stock Dividends Paid	(\$1,349)	(\$1,118)
Additions to PP&E	(\$658)	(\$564)
Adjusted FCF	\$4,214	(\$1,624)

Company	Microsoft
Report Date	29-Apr-11
Price	25.45
Growth Rate	8.00%
Price/Sales	3.14
Price/ Net Cash Flow	10.78
Price/ Net Book Value	5.40
P/E Ratio Current	9.64
P/E Ratio Year 2	9.02
Current Ratio	2.76
Quick Ratio	2.71
LT Debt / Shr. Equity	22.29%
LT Debt / Current Assets	17.98%
Return on Shr. Equity	42.09%
PEG Ratio (Current)	1.21
PEG Ratio Year 2	1.13
PEGY Ratio (Current)	0.92
PEGY Ratio Year 2	0.86
Graham Ratio (current)	52.09
Graham Ratio Year 2	48.76
Growth Flow Ratio (s/b <12=nrml)	6.88
Cash King (s/b > 10 %)	29.10%
Flow Ratio (s/b < 1.25)	0.67
Intrinsic Value (current)	51.74
Intrinsic Value Year 2	55.27

Intrinsic Value Year 3	59.69
Intrinsic Value Year 4	64.47
Intrinsic Value Year 5	69.63
Intrinsic Value / Price (current)	103.32%
Intrinsic Value / Price Year 2	117.18%
Intrinsic Value / Price Year 3	134.55%
Intrinsic Value / Price Year 4	153.32%
Intrinsic Value / Price Year 5	173.58%

May 4, 2011 Sears 2010 Chairman Letter and Microsoft

"Shareholder Value

In 2010, Apple surpassed Microsoft in total market capitalization, making it the most valuable technology company in the world and the second most valuable company overall after Exxon Mobil.

In Apple's case, its market capitalization increase has been driven by two factors. First, Apple has delivered incredible improvements in operating performance resulting from a decade of innovation, both in product design and in business model. The creation of iTunes and the App Store coupled with the creation of the iPod and the iPhone defied the conventional wisdom that success required open systems. At a time of increasing openness and interoperability of software and hardware, Apple promoted its own proprietary systems, keeping tight control over the design and integration of its products and the applications that make them useful. It developed a system for protecting the intellectual property of music companies and a system for promoting the properties of independent application developers based upon a combination of ratings and micropayments.

Second, Apple has neither repurchased shares nor paid a dividend since 2003. Currently, Apple sits on about \$60 billion of cash and investments, while generating almost \$20 billion in cash (after-tax) over the last year. It is the combination of spectacular operating performance and cash retention that has led to a market capitalization that eclipses all but Exxon Mobil.

In contrast, over the past four years, Microsoft has repurchased around \$40 billion of its own shares, in addition to paying out almost \$18 billion of dividends, for a total of almost \$60 billion or about the same amount of cash that Apple currently carries on its balance sheet. Despite this, Microsoft still carries almost \$50 billion in cash and investments. Had Microsoft set a goal to have its overall market value be higher than other companies, there are many things it could have done to make this happen, including not

repurchasing shares or paying dividends.

Suppose, for example, that Microsoft had not returned \$60 billion in cash to shareholders over the past four years. In that case, its market capitalization would have been \$60 billion higher than it is today. Meanwhile, suppose that Apple returned to shareholders the \$60 billion in cash and investments currently on its balance sheet. Then Microsoft's market capitalization would currently be higher than Apple's. The point is that the attention some have placed on overall market value rather than per share value is misplaced from the vantage point of an investor in a company. Sheer size may make for interesting headlines, but it may distract from doing the optimal things for the shareholders of a business. (Apple's per share performance, by the way, has also been spectacular.)

If one owns 10% of a company, or 1% of a company or .0000001% of a company, what matters is how that investment fares over time. A company worth \$1 billion that doubles in value to \$2 billion only doubles an owner's investment if the number of shares outstanding remains constant. Merging with another company with a \$1 billion market capitalization and issuing shares to effect that merger would leave the 10% owner of a \$1 billion company with a 5% stake in a \$2 billion market value company. In both cases, the value of that investment is \$100 million. Taking that logic down to the lowest possible unit, 1 share, serves to demonstrate and emphasize the logic of focusing on per share value as the key measure for shareholders.

At Sears Holdings, we seek to create long-term value for our shareholders. Like Apple, we seek to do so by improving our operating performance, innovating, and delighting customers. In this area, we have fallen far short of our goals and what we aspire to do in the future. On the second dimension of capital allocation, I believe that our behavior and focus has served our shareholders well over the past eight years and will magnify the value creation when our operating performance improves. We built cash when we felt that it was the right decision for our shareholders, and we delivered cash to those who elected to sell their shares when we felt that it was the right thing to do.

Share repurchases are not a panacea, nor are they a singular strategy. Yet, they are more than just the return of capital to shareholders. They represent an investment by the non-selling shareholders in the future of the business and the company. By repurchasing shares from selling shareholders, the remaining shareholders increase their ownership stake, thereby taking the additional risk and additional upside potential based upon future performance. When coupled with outstanding operating performance, share repurchases magnify returns. When the price paid is attractive relative to future performance, share repurchases magnify returns. As a form of discipline on alternative capital allocation strategies, share repurchases can magnify returns. But, at the wrong price, with poor future performance,

share repurchases can harm returns.

Despite our challenging performance over the past several years, the difficult economic environment, and the dramatically changing retail environment, we have generated very attractive returns for shareholders since May 2003, when we assisted Kmart in its emergence from bankruptcy. Others in our industry have grown their revenues since that time, some have grown their profits, but many have been unable to deliver shareholder performance in the past eight years.

In order for us to fulfill the potential of the company, we need to improve. We will continue to provide great opportunities for talented individuals to run businesses, while holding them accountable for performance. We have a need to manage the scale of our operations at the same time as we transform them. The activities required for transformation are vast and time-consuming. As the retail industry is reinvented, we intend and expect Sears Holdings to be a significant player in this reinvention. By aligning our associates with our customers, not with our stores or products, we believe this reinvention will play out in our favor.

Thank you for your patience and your trust.

*Respectfully,
Edward S. Lampert"*

I think that Ballmer will be remembered as a patient and shrewd deployer of capital.

April 29, 2011 (25.45) Review of 3Q11 earnings

1. Morningstar 4/29/11:

Microsoft Corporation MSFT [Nasdaq] | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
26.71 USD	32.00 USD	22.40 USD	44.80 USD	Medium	Wide	A	AAA	Software - Infrastructure

2. Microsoft had declining revenues in Windows. They blamed consumer and Japan. Increased enterprise revenues. They did not really mention tablets taking away market share. Analysts have been writing that Microsoft must acknowledge this shift, as well as develop a proper tablet.

3. Credit Suisse 4/29/11

Financial and valuation metrics

Year	06/10A	06/11E	06/12E	06/13E
EPS - (Excl. ESO) (US\$)	2.11	2.55	2.82	3.34
EPS (CS adj.) (US\$)	2.11	2.55	2.82	3.34
Prev. EPS (CS adj.) (US\$)	—	2.57	2.81	3.25
P/E (CS adj., x)	12.7	10.5	9.5	8.0
P/E rel. (CS adj., %)	73.4	71.7	73.8	—
Revenue (US\$ m)	62,484.0	69,688.0	74,569.0	81,424.4
EBITDA (US\$ m)	24,098.0	27,224.7	29,303.5	32,813.0
Net debt (US\$ m)	-38,603	-50,020	-54,916	-61,091
OCFPS (US\$)	2.70	3.18	3.52	3.97
P/OCF (x)	8.5	8.4	7.6	6.7
Number of shares (m)	8,402.38	Price/sales(x)		3.22
BV/share (current, US\$)	5.7	P/BVPS (x)		4.7
Net debt (current, US\$ m)	-41,603.0	Dividend (current, US\$)		0.64
Dividend yield (%)	2.4			

Source: Company data. Credit Suisse estimates.

4. **Merrill Lynch 4/29/11**

Key Changes

(US\$)	Previous	Current
2011E Rev (m)	69,526.5	69,731.7
2012E Rev (m)	72,528.4	75,110.1
2013E Rev (m)	76,664.6	80,243.3
2011E EPS	2.55	2.57
2012E EPS	2.74	2.81
2013E EPS	3.04	3.14

Income Statement Data (Jun)

(US\$ Millions)	2009A	2010A	2011E	2012E	2013E
Sales	58,437	62,484	69,732	75,110	80,243
% Change	-3.3%	6.9%	11.6%	7.7%	6.8%
Gross Profit	46,282	50,089	54,054	57,981	62,348
% Change	-5.2%	8.2%	7.9%	7.3%	7.5%
EBITDA	23,343	26,771	29,725	32,056	33,651
% Change	-10.1%	14.7%	11.0%	7.8%	5.0%
Net Interest & Other Income	(14)	915	905	1,094	1,379
Net Income (Adjusted)	15,272	18,760	22,013	23,011	24,646
% Change	-13.8%	22.8%	17.3%	4.5%	7.1%

Free Cash Flow Data (Jun)

(US\$ Millions)	2009A	2010A	2011E	2012E	2013E
Net Income from Cont Operations (GAAP)	14,569	18,760	22,013	23,011	24,645
Depreciation & Amortization	2,562	2,673	2,765	2,470	2,170
Change in Working Capital	(178)	661	459	835	574
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	2,084	1,979	1,799	3,114	3,458
Capital Expenditure	(3,119)	(1,977)	(2,513)	(2,500)	(2,500)
Free Cash Flow	15,918	22,096	24,523	26,930	28,347
% Change	-13.6%	38.8%	11.0%	9.8%	5.3%

Balance Sheet Data (Jun)

(US\$ Millions)	2009A	2010A	2011E	2012E	2013E
Cash & Equivalents	6,076	5,505	7,492	1,464	730
Trade Receivables	11,192	13,014	12,390	11,434	10,412
Other Current Assets	32,012	37,157	53,164	71,976	91,145
Property, Plant & Equipment	7,535	7,630	8,184	8,585	9,240
Other Non-Current Assets	21,073	22,807	25,617	25,233	24,965
Total Assets	77,888	86,113	106,848	118,692	136,493
Short-Term Debt	2,000	1,000	0	0	0
Other Current Liabilities	25,034	24,965	26,789	28,129	30,076
Long-Term Debt	3,746	4,939	9,671	9,671	9,671
Other Non-Current Liabilities	7,550	8,852	9,088	9,537	9,563
Total Liabilities	38,330	39,756	45,548	47,337	49,310
Total Equity	39,558	46,357	61,300	71,355	87,183
Total Equity & Liabilities	77,888	86,113	106,848	118,692	136,493

* For full definitions of *iQmethod*SM measures, see page 11.

November 16, 2010 R (25.82) Comparing Metrics to 2000

	2011E	2006	2000
Price	25.82 11/16/10	24.70 8/25/06	38.72 3/3/00
Sales Per Share	8.05	4.40	2.25
Cash Flow Per Share	2.80	1.34	0.99
Earnings Per Share	2.45	1.20	0.85
Dividends Per Share	0.64	0.34	0.00
Book Value Per Share	6.95	3.99	4.05
Shares Outstanding	8,500	10,062	10,218
Dividend Yield	2.48%	1.3%	0.00%
Sales	68.50B	44.2B	22.96B
Operating Margin	44.0%	39.2%	51.3%
Net Profit Margin	30.9%	28.5%	41.0%
Long Term Debt	10.665B	0	0
Shareholder Equity	59B	40B	41B
Return on Capital	31.0%	31.4%	22.8%
Return on Equity	36.0%	31.4%	22.8%
Dividend retained to Net Profit	26%	28%	N/A
Market Cap	219.5B	248.5B	395.6B
Estimated Annual Growth Rates			
Sales	9.5%	18.0%	24.5%
Cash Flow	11.0%	16.0%	25.5%
Earnings	12.5%	13.5%	29.0%
Dividends	14.0%	24.5%	0.00%
Book Value	18.5%	3.5%	37.0%
Metrics			
Price To Sales	3.2X	5.61X	17.21X
Price To Cash Flow	9.22X	18.43X	39.11X
Price To Book Value	3.72X	6.19X	9.56X
Price to Earnings	10.54X	20.58X	45.55X
RBCO Intrinsic Value Year 1	43	N/A	14
RBCO Intrinsic Value Year 5	57	N/A	25
Gates Ownership %	7.2% (11/19/10)	9.6%	15.3%

Officers and Directors %	5.2%	4.2%	10.2%
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November 15, 2010 (26.26) Barron's reviews Kinect "Thinking Outside the Xbox."

1. "amazing technological feat."
2. Appeals more to younger kids with politically correct games.
3. My thoughts are the writer (David Schutt) is not a gamer and that he might be out of touch with the power of the Call of Duty's and Halo.

October 28, 2010 (26.28) R Review of 10-Q "So far, so good. No change in thesis, if anything thesis has been enhanced."

1. Revenues were \$16.2B, whereas Value Line (8/20/10) projected \$15.6B.
2. EPS reported at \$0.62, whereas Value Line projected \$0.55. NI was \$5,410, Value Line projected shares of 8,500. Hence it looks like VL projected earnings of \$4,675.
3. Tax provision was 25.17%. Slightly higher than prior quarters. We have been projecting 25%.
4. Cash and Equivalents are \$44,173. At FYE 6/30/10 they were \$36,788. During quarter MSFT bought back shares for \$4,399, and took on debt of \$4,721.
5. Stockholders Equity is \$46,942. Goodwill is \$12,471. I did not reduce book value for intangibles of \$1,077. Tangible Book Value is \$34,471, or \$3.96 per share.
6. Quick unorthodox cash flow analysis

	3 months ending 30-Sep-10	3 months ending 30-Sep-09
Net Income	\$5,410	\$3,574
Add Back:		

Depreciation and Amortization	\$694	\$646
Gains on Derivatives	(\$29)	(\$66)
Deferral of Unearned Revenue	\$5,881	\$6,679
Recognition of Unearned Revenue	(\$6,862)	(\$6,237)
Adjusted Cash Flow from Operations	\$5,094	\$4,596
Debt Repayments	(\$814)	(\$823)
Common Stock Repurchased	(\$4,399)	(\$1,540)
Common Stock Issued	\$177	\$248
Common Stock Dividends Paid	(\$1,118)	(\$1,157)
Additions to PP&E	(\$564)	(\$435)
Adjusted FCF	(\$1,624)	\$889

7. Repurchased 163M shares during quarter. \$19.7B remains on share repurchase of \$40B announced on 9/22/08. Average price seems to be \$24.54 for 1Q11. Page 46 identifies prices of \$24.73 – \$24.45 paid.

October 12, 2010 (24.75) R General review

1. I finished reviewing 10-K last week. Really not much to report.
2. I think the Valuation analysis from 20100726 J is as close of a projection as we are going to get. Based on that spreadsheet, and what I would consider to be conservative assumptions, I do not think that a reduction in holdings would be warranted until at least \$40 per share. At \$40, and all things staying the same, we would **possibly** consider a reduction of allocation. At \$45 per share, we see the potential of losing double digit long term IRR. Not a bad thing, and hopefully one we have to deal with. Hence, a **possible** reduction of allocation at \$40, and probable reduction at \$45.
3. I worked with intrinsic value worksheet. I used 2011 as starting date, a 5% corporate bond rate, and a 5% growth rate. Keep in mind I reduced our bond rate from John's which was 6%, and his growth rate is 8%. His methods were conservative, and I fully agree with them. I was just using a different angle. With that said, I projected eps at F2011 of \$2.40, F2012 of \$2.52, F2013 of \$2.65, F2014 of \$2.78 and F2015 of \$2.92. I think my projections are materially conservative, and just trying to emphasize conservatism (I hope.) With those assumptions we get an intrinsic value of F2011 of \$39.07, F2012 of \$41.03, F2013 of \$43.08, F2014 of \$45.23 and F2015 of \$47.49. Of course just a road map. I would not ultimately be

surprised to see F2015 earnings to be \$3.17, with an intrinsic value of \$57.03 (which is quite close to John's spreadsheet from 9/27/10).

4. **Argus Note 9/17/10**

- a. Hold rating
- b. Concerned with uncertainty of cloud computing and potential threat to PC operating systems.
- c. Mentions IE9, something we haven't even discussed yet. I will first mention that I have heard good reviews of IE9. Yet, Argus indicates that revisions and updated products are expected and part of the game. I would certainly agree with that. Argus thinks IE9 could slow erosion to Chrome and Firefox.
- d. Risks include global downturn in software investment spending.
- e. Concerned with Google competition. I think this is certainly a legitimate concern, and one of ours (See thesis dated October 11, 2010). Yet, they claim mobile operating system is an also-ran. Yet, on October 11, 2010, we saw the debut of WP7. Argus could possibly be wrong on their death sentence.
- f. Projects eps of \$2.31 and \$2.53 for F2011 and F2012 respectively. John as a side note projected \$2.40 and \$2.59 for F2011 and F2012 respectively.

5. **Credit Suisse in a note dated 9/23/10** (Springsteen's 61st birthday) projected F2011 eps of \$2.46. They project \$2.82 F2012, and \$3.26 in F2013. Our projections are considerably under CS. MSFT remains their top pick in large cap software.

6. **Morgan Stanley in a note dated 10/7/10** - "WP7 is a pivotal release for MSFT's strategic positioning." They indicate that mobile is ~1% of Revenues. Projected F2011 eps of \$2.28. They project \$2.53 F2012, and \$2.87 in F2013. I was not familiar that WP7 has Xbox live integration. If I am understanding that correctly, it could certainly be huge (Am I falling too in love with Mr. Softy?) CDMA version of phone due in 2nd half of 2011.

7. **Standard and Poors August 12, 2010** - Thinks gross margins will narrow to 79% from 80% in F2011. Operating margins expected to stay at 38% because of economies of scale. Reduced to hold from buy, based on concern of slowing global economy. Thinks Bing will gain market share. F2011 eps projected at \$2.24. F2012 Projected at \$2.40.

8. **Morningstar 10/11/10** – Still 5 ***** rated, Consider sell at \$44.80 and Fair Value of \$32.00. Not sure if WP7 will be a hit, but thinks possibility exists. They cite this mostly because developers are familiar with operating system. Prior WP this was not the case according to M*.

October 11, 2010 (24.55) R Thesis Revisited

1. Immaculate balance sheet.
2. Lots of cash.
3. I think in time, the potential exists that Ballmer will be praised for his fiscal patience.
4. FCF and earnings, are both of high quality, and I believe both to be stable at a minimum. Compare that to the price you pay, and I like the yield.
5. I think major industry and world will continue with the Windows and MSFT platform for years to come. I was speaking with a big Pharma guy today. He is in software. I asked, "Do you see any possibility that MSFT will not be a major player in 5 or 10 years." He said, "NFW, They ain't going away."
6. Nice dividend, but that can be combined with FCF discussion.

My favorite part of the investment thesis is the current price. Of course, could go lower, a lot lower, but that is the way investing is.

Most of the above has all been said by others. Really isn't a hell of a lot to analyze here.

It seems to me that for the first time in generations, we are able to buy large blue chips and not pay the typical premium one would have to pay for continuity of earnings and safety.

Where is the revenue decline?

Year Sales

06/10 62,484
06/09 58,437
06/08 60,420
06/07 51,122
06/06 44,282
06/05 39,788
06/04 36,835

06/03 32,187
06/02 28,365
06/01 25,296

I think many think that revenues have not been increasing, or in decline. Maybe the stock price catalyst would be the understanding of the simple math, and seeing that revenues, contrary to popular perception have been on the rise for a decade + (not including F2009 where there was a decline.)

Many investors are under the impression that Microsoft puts out mediocre products.

Other than Zune (and not sure that game is over yet), what would mediocre product be? Just looking at gaming, it seems like Xbox 360 is the cream of the crop. Xbox live is an annuity. Halo Reach is being enjoyed by all.

<http://xbox360.ign.com/objects/142/14276699.html>

One of my kids is in 7th grade. It seems like every kid in the school is an Xbox live subscriber. If you aren't familiar, the subscription (less than \$70 per year) gives them the ability to play multiplayer games with their friends or team, in a fashion that has no delay, etc. They wear headsets or such, and really play as though they are next to each other.

Perhaps Windows Phone 7 will surprise and be well received.

Yet, I do have concerns on Google docs, etc. I try to invert my thesis, and I have concerns (hopefully not legitimate concerns), that Office, will become Lotus 123.

September 27, 2010 (24.73) J

Updated intrinsic value schedule result and assumptions:

30 year bond rate	6%	6%
EPS growth rate	12.5%	8%
2010 eps	\$2.10	\$2.10
2011 est eps	\$2.40	\$2.40
Intrinsic value	\$51.59	\$37.73

Value line uses a 12.50% growth rate. In the interest of being conservative, I have presented a lower growth rate of 8%. Lowering the growth rate by 4.5% has the effect of lowering the current intrinsic value by 27%.

August 18, 2010 (24.86) J

Review of 8/20/10 Value Line

- Windows 7 and Office 2010 will be positive factors in fiscal 2011
- Business activity should pick up; this includes server and tools, and Windows Azure
- Xbox remains a popular console
- Company is intent on pursuing a range of opportunities in mobile market
- Raising fiscal 2011 estimate to \$2.40 per share (+\$0.10)
- Current valuation is markedly below market median and may interest investors with an intermediate horizon

July 26, 2010 (26.00) J

MSFT reported fiscal year end (6/30) on July 22. The quarterly revenue was \$16.0B vs. an estimate of \$15.2B and eps was \$.51/share vs. an estimate of \$.46. Despite this good report, shares are little changed. Pundits complained of the slow-growth (4Q revenue was +22% vs. last year) and focused on the decline of Windows (4Q revenue +44% vs. last year) as an update was released.

Various computations based on 8-K filing:

Current Price (7/26/10)	\$26.00
6/30/10 Shareholders' equity	\$46,175
Wtd average diluted shares	8,924
Book value per share	\$5.17
Goodwill	12394
Intangibles	1158
Tangible book value per share	\$3.66
Price/book	5.02
Price/tangible book	7.11
Cash & ST Investments	\$36,788
Less: ST Debt	1,000
LT Debt	4,939
Net Cash	\$30,849
Net Cash per share	\$3.46
Share price minus net cash	\$22.54
2010 earnings	\$2.10
P/E ex-cash	10.73

My estimate of current share value is \$35 - \$40 as calculated below:

Potential valuation	
----------------------------	--

calculations	
Past 5 yr avg P/E	18.90
2010 eps	\$2.10
Potential share price	\$39.69
or	
2010 eps	\$2.10
Assumed P/E	15.00
	\$31.50
Add: Net cash	\$3.46
Potential share price	\$34.96

According to my estimates, the shares could be undervalued by 35%-50%. In addition, the shares pay a 2% dividend.

I ran the valuation analysis with the fiscal year end earnings. I ran the analysis using growth rates of 5% for 10 years and 3% for years 10-15 and also ran it using 7% growth for 10 years and 2% in years 10-15. In each case the ROI was 15% or better (I also used 3 times tangible book). Assuming a P/E of 15, the ROI was around 8%.

Breakdown of revenues by division:

	For Quarter Ended		
Division revenue	6/30/2010	6/30/2009	Change
Windows & Windows Live	4,548	3,169	43.52%
Server and Tools	4,012	3,528	13.72%
Online Services	565	501	12.77%
Microsoft Business	5,250	4,567	14.96%
Entertainment & Devices	1,600	1,257	27.29%
Other	64	77	-16.88%
Total	16,039	13,099	22.44%
	For Year Ended		
	6/30/2010	6/30/2009	Change
Windows & Windows Live	18,491	14,974	23.49%
Server and Tools	14,866	14,191	4.76%
Online Services	2,199	2,121	3.68%
Microsoft Business	18,642	18,910	-1.42%
Entertainment & Devices	8,058	8,035	0.29%
Other	228	206	10.68%
Total	62,484	58,437	6.93%

Windows revenue increase was due to strong sales of Windows 7 and PC market improvement. PC shipments grew 16% to 18% worldwide. Server and Tools increase was due to growth in Windows Server, SQL server and Enterprise CAL Suites.

Online services included higher search and display advertising revenue offset by decreased advertiser and publisher tools revenue. Operating loss increased due to Yahoo reimbursement and higher advertising for Bing.

Business services 4Q revenue increase driven by Office 2010.

Xbox shipments declined to 10.3M consoles in fiscal 2010 vs. 11.2M in prior year.

I would continue to hold current position and would buy for new accounts. This is our largest equity position and I think results support that large position. As noted above, I think at \$35-40 per share, the shares are fairly valued and would probably reduce at that time if nothing has changed.

Others:

Credit Suisse (7/23/10) (\$25.84 price) Report titled “What More Do You Want?” after results. MSFT remains their top large-cap pick with a \$40 target. Mostly solid results in all divisions, excluding Online Services. Could have robust earnings growth with new products. “What now? BUY THE STOCK.”

S&P (7/24/10) (\$25.81 price) Rated as a Buy with a price target of \$35. They raised the target by \$1 after earnings. The investment rationale will be updated shortly after review of earnings report.

Morningstar (7/22/10) (\$25.81) Rated as 4 stars with a FV of \$32 and a consider buy of \$22.40. Strong PC market drove a record fiscal 4th qtr. Windows and Office franchises are in the early stage of a long decline. The future of MSFT lies in its Windows Azure cloud platform.

June 7, 2010 The High Tech Strategist issue #271 June 4, 2010 Notes of mine from reading (R)

1. Claims analysts expect \$0.46 for quarter ending June. Hickey expects earnings to be at least \$0.55 for same period.
2. Corporate PC upgrade cycle has just begun. Windows 7 is one of the reasons for such.
3. A few weeks of sales from Office 2010 and SharePoint 2010.
4. “Big bottom line numbers for several straight quarters.”
5. Does not think Ballmer’s comments on a debt crisis not being isolated in Europe is a concern. Thinks he was talking more general climate than company specific.
6. Thinks Wall Street is looking at MSFT as “dead money.” Claims that AAPL and MSFT have same revenues, yet MSFT twice as profitable.
7. Doesn’t see Google Apps as a current threat. He claims this is via an Information Week Analytics Industry survey.
8. “Best time to buy a stock is when the crowd hates it, even though they shouldn’t.”
9. “Extraordinary opportunity, as long as economy doesn’t tank.”

May 24, 2010 R 26.48 Review of 5/21/10 Value Line.

1. Praises Windows 7.
2. MSFT has deferred \$300M from new productivity suite, which should be recognized in 2Q11 (I think that is 12/31/10).
3. Thinks hardware and IT spending to be strong, and that should make Server and Tools strong.
4. EPS projected for \$2.05 in F2010, and \$2.30 in F2011. 2013 – 2015 they project a range of \$3.00.
5. EPS growth rates of 10.5% projected.
6. Dividend payout ratio is projected at 24% for F2011. They expect dividend raise in F2011 to \$0.56, from \$0.52.
7. ROE's have been > 30% since 2006. They project 36.5% in 2011, and 39.0% in 2010.

5/19/10 Microsoft (MSFT) 28.35

Current year eps estimate 2.05, PE 13.8; and next year eps estimate of 2.32, PE 12.2. Very similar to WMT from valuation. Tons of cash on balance sheet. Current dividend of .52 (1.8%). Probably one of my favorite companies. Probably would go down in general market decline and we should look to capitalize on decline with purchases.

April 26, 2010 (31.15) J

MSFT reported earnings last week. MSFT earned .45/diluted share for qtr ending 3/31/10 vs. .33/share last year and 1.59/diluted share for the 9 months ended 3/31/10, vs. 1.28 for the 9 months ended 3/31/09. There appears to be a great deal of upside for the new version of Windows. Potential increased sales as businesses upgrade from XP (thought is that businesses skipped Vista). New version of Office is due this summer and could benefit the company substantially.

The company announced a \$40B share buyback in Sept 2008 and as of March 31, 2010 had \$27.5B remaining. During the qtr ended March 31, it bought back approx. 67M shares at a cost of \$2B. The repurchase program expires 9/30/2013.

I updated valuation schedule and the potential returns are very good. Using 3 times tangible book and growth rate of 5%, the potential ROI returns are 12%-13%. I started with eps this year of \$1.91, while consensus is around \$2.05. MSFT already earned \$1.59 this year so I am projecting just .32/share in 4th qtr – a very pessimistic view, in anyone's book.

The one area of the company that continues to falter is the on-line services. This division consists of Bing, MSN, and the Yahoo partnership. Revenues did increase 12% in the qtr end 3/31/10 vs. the qtr end 3/31/09, but the operating loss increased 73% over last year.

Some details from the 3/31/10 Q:

	9 mos. end 3/31/10	9 mos. end 3/31/09	% change	3/31/2010 % of total	3/31/2009 % of total
Revenue					
Windows & Windows live	13,328	11,393	16.98%	28.70%	25.13%
Server and Tools	10,862	10,714	1.38%	23.39%	23.63%
Online services	1,632	1,613	1.18%	3.51%	3.56%
Business division	13,706	14,315	-4.25%	29.51%	31.57%
Entertainment & devices	6,499	6,778	-4.12%	13.99%	14.95%
Unallocated/other	<u>418</u>	<u>525</u>	-20.38%	0.90%	1.16%
	46,445	45,338	2.44%		

	9 mos. end 3/31/10	9 mos. end 3/31/09	% change	3/31/2010 % of total	3/31/2009 % of total
Operating income					
Windows & Windows live	9,914	8,053	23.11%	54.57%	49.18%
Server and Tools	3,945	3,597	9.67%	21.71%	21.97%
Online services	-1,659	-1,067	55.48%	-9.13%	-6.52%
Business division	8,492	8,958	-5.20%	46.74%	54.70%
Entertainment & devices	851	249	241.77%	4.68%	1.52%
Corporate level	<u>-3,375</u>	<u>-3,414</u>	-1.14%	-18.58%	-20.85%
	18,168	16,376	10.94%		

	9 mos. end 3/31/10	9 mos. end 3/31/09	% change
Free cash flow			
Net income	14,242	11,524	23.59%
Add: Depreciation/amort	1,955	1,881	3.93%
Less: Cap ex	1,219	2,252	-45.87%
Less: Acquisition of companies	<u>245</u>	<u>827</u>	-70.37%
Free cash flow	14,733	10,326	42.68%

	9 mos. end 3/31/10	9 mos. end 3/31/09	% change
Stockholders equity	45,710	39,558	
9 month avg diluted shares	8,955	9,008	
Book value/share	5.10	4.39	16.24%
Goodwill	12,463	12,503	
Intangibles	1,282	1,759	
Tangible book/share	3.57	2.81	27.11%

Management has been selling option proceeds. Small market purchase by director but not material. Bill Gates continues to sell but that is expected as the proceeds are devoted to his charity work.

There is great potential for MSFT with the introduction of Windows 7 and the release of Office 2010 later this year. Earnings could grow by 20% or 30% next year. If we assume 2011 eps of \$2.5, PE is 12.5, and the company has \$4/share in cash. If we use a PE of 15 on next year's earnings and add the \$4, we could see a price of near \$40. I would continue to buy here. It is our largest position and I think we will be pleased with returns over the next several years.

Other analyst reports:

Credit Suisse (4/23/10) rated outperform with price target of \$40. In deference to the recent NFL draft, CS titles the report, "And with the first pick....Microsoft!". It is their top large-cap pick and raises price target from \$36.50 to \$40. They estimate FY 2011 revenues of \$68.5B and eps of \$2.41.

Good:

Windows revenue increased 28.3%; Operating margins of 35.7% vs. consensus of 32.9%.

Bad:

Server and tools revenue up 2.4%; Business division revenue declined 5.9%.

Thesis:

MSFT could drive a robust trough to peak eps growth rate as the company benefits from overlapping Windows, SQL server, Xbox, and Office product cycles as well as rebound in PC shipments. They feel market has undervalued MSFT ability to expand margins for the next several years and also the sustainable revenue growth and defensive competitive characteristics of MSFT dominant market positions.

S&P (4/23/10) rated a buy with a price target of \$34 based on improving economy and a sharp rebound in PC sales. They are looking for a strong consumer adoption of Windows 7 and an upgrade cycle on the business front. Risks include a further slowdown in the global economy, losses in the desk top operating systems market and lower than projected PC sales. \$34 price is based on 15 PE on 2011 eps of \$2.21. (J-I think this is too conservative.)

Merrill Lynch (4/23/10) rated as a buy with a price target of \$37. They have estimated of 2011 eps of \$2.26, though they note there is potential for upside if Windows 7 or Office 2010 take hold. They noted decline in Unearned revenues, yet contracted but not billed revenues increased which they note is good for the future.

Morgan Stanley (4/23/10) rated as a buy with \$38 price. Solid quarter with a lot of potential upside going forward. Expect MSFT to outperform as analysts upgrade estimates.

February 22, 2010 (28.79)(R) Review of 2/19/10 Value Line

1. Windows 7 experiencing healthy demand.
2. Office 2010 expected to be released “soon,” likely to give MSFT revenue growth for subsequent quarters.
3. Upward guidance in Revenues to \$61,370 FYE 6/30 and earnings to \$2.00. Attributed to Windows 7 coming out of deferred revenue. **(FYE... We are projecting \$1.63 FYE 6/30/10, see 11/10/09.)**
4. Thinks MSFT second half of F2010 “should be a good one.”
5. Dividend is \$0.52, with a yield of 1.81%.

November 10, 2009 (29.01)(R)

1. On my 11/06/08 notes I wrote, “Full year revenue of 64.9 to \$66.4B.” Revenues for Year Ended June 30, 2009 were \$58,437. That is a big miss, no? Full year 2008 Revenues were \$60,420.
2. Tax Rates need to be watched. Reducing tax rates could be used as method of manipulating earnings.

	3 months 9/09		3 months 9/08	
Revenues	\$12,920	100.00%	\$15,061	100.00%
Operating Income	\$4,482	34.69%	\$5,999	39.83%
Other Income	\$283	2.19%	(\$8)	-0.05%
Income Before Taxes	\$4,765	36.88%	\$5,991	39.78%
Provision for Taxes	\$1,191	24.99%	\$1,618	27.01%
Net Income	\$3,574	27.66%	\$4,373	29.04%
Shares Outstanding	8983		9183	
Year Ended June 30--->>>	6/30/2009		6/30/2008	6/30/2007

Revenues	\$58,437	100.00%	\$60,420	100.00%	\$51,122	100.00%
Operating Income	\$20,363	34.85%	\$22,271	36.86%	\$18,438	36.07%
Other Income	(\$542)	-0.93%	\$1,543	2.55%	\$1,663	3.25%
Income Before Taxes	\$19,821	33.92%	\$23,814	39.41%	\$20,101	39.32%
Provision for Taxes	\$5,252	26.50%	\$6,133	25.75%	\$6,036	30.03%
Net Income	\$14,569	24.93%	\$17,681	29.26%	\$14,065	27.51%
Shares Outstanding	8996		9470		9886	

3. Cash and ST equivalents are \$36.7B, at year end 2009 they were \$31.4B. All other assets stayed similar. A/R went down. Nothing looked unusual. Liabilities stayed constant, nothing sticks out.
4. Stockholders Equity \$41,212.
5. Cash Flow has been eaten for 3+ years now. This has been because of Stock Buy Backs only. See table below.

**3 months
9/09**

**3 months
9/08**

Cash Flows

Net Income	3574	27.66%	9183	29.04%
Depreciation	646	5.00%	585	3.88%
Operating Cash Flow	4220	32.66%	9768	64.86%

Less:

Dividends	-1157	-8.96%	-998	-6.63%
Stock Buy Back	-1540	11.92%	-6493	43.11%
CapEx	(\$435)	-3.37%	(\$778)	-5.17%
Companies Acquired	(\$39)	-0.30%	(\$377)	-2.50%
Free Cash Flow	\$1,049	8.12%	\$1,122	7.45%
Stock Buy Back	\$1,540		\$6,493	

**Year Ended June
30--->>>**

	6/30/2009		6/30/2008		6/30/2007	
Net Income	\$14,569	0.00%	\$17,681	0.00%	\$14,065	
Depreciation	\$2,562	4.38%	\$2,056	3.40%	\$1,440	2.82%
Operating Cash Flow	\$17,131	29.32%	\$19,737	32.67%	\$15,505	30.33%
Less:						
Dividends	(\$4,468)	-7.65%	(\$4,015)	-6.65%	(\$3,805)	-7.44%
Stock Buy Back	(\$9,353)	16.01%	(\$12,533)	20.74%	(\$27,575)	53.94%
CapEx	(\$3,119)	-5.34%	(\$3,182)	-5.27%	(\$2,264)	-4.43%
Companies Acquired	(\$868)	-1.49%	(\$8,053)	13.33%	(\$1,150)	-2.25%
Free Cash Flow	(\$677)	-1.16%	(\$8,046)	13.32%	(\$19,289)	-37.73%
Stock Buy Back	\$9,353	47.19%	\$12,533	52.63%	\$27,575	137.18%
FCF W/Out buyback	\$8,676		\$4,487		\$8,286	

6. Projecting forward, using some pretty bad case scenarios, but not Draconian, you get some decent valuations.

Microsoft	MSFT

As of Date	September 30, 2009
EV Analysis	
	November 10, 2009
Share Outstanding	8,983.00
Share Price	\$29.01
Market Capitalization	\$260,596.83
Less: Cash and Short Term Investments	(\$36,728.00)
Add: Long Term Debt	\$3,746.00
Minority Interest	\$0.00
Enterprise Value	\$227,614.83
EV per share	\$25.34
Stockholders' Equity	\$41,212.00
Adjustments:	
Goodwill	(\$12,582.00)
Tradenames	\$0.00
Other Intangibles	(\$1,653.00)
Net Stockholders' Equity	\$26,977.00
Adjusted Book Value per Share	\$3.00

Quick Projections 2009	November 10, 2009
Revenue	\$58,000.00
Net Margin % before tax	36.00%
Net Margin before taxes	\$20,880.00
Tax Rate	30.00%

Corporate Taxes	\$6,264.00
Net Income after Taxes	\$14,616.00
Net Margin %	25.20%
Shares Outstanding	8,983.00
eps	\$1.63

FV of current equity and future earnings 10-Nov-09

Adjusted Stockholder's Equity \$26,977.00

Net Profit \$14,616.00

Growth Rate of Net Profit for 10N **5.00%**

Growth Rate of Net Profit after 10N through 15N **5.00%**

FV of Net Profit in 10N \$23,807.92

FV of Net Profit in 15N \$30,385.61

FV of tangible book value plus Net Profits for 10N \$227,781.17

FV of tangible book value plus Net Profits for years 11 - 15N \$422,266.71

Current Enterprise Value \$227,614.83

FV of tangible book value plus Net Profits for 10N Years **(\$227,781.17)**
10

ROI on tangible book value plus Net Profits for 10N 0.01%

FV of tangible book value plus Net Profits for 10N \$227,781.17

FV of tangible book value multiplier 3.00

FV of Tangible Book Value using BV multiplier in year 10 **\$683,343.50**

Current Enterprise Value \$227,614.83

FV of tangible book value plus Net Profits for years 11 - 15N **(\$422,266.71)**
15

ROI on tangible book value plus Net Profits for 15N 4.21%

FV of tangible book value plus Net Profits for 15N	\$422,266.71
FV of tangible book value multiplier	3.00

FV of Tangible Book Value using BV multiplier in year 15	\$1,266,800.14
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Potential Future EV using BV multiplier above

Current Enterprise Value	\$227,614.83
FV of Tangible Book Value using BV multiplier in year 10	(\$683,343.50)
Years	10
ROI on FV of Tangible Book Value using BV multiplier in year 10	11.62%

Current Enterprise Value	\$227,614.83
FV of Tangible Book Value using BV multiplier in year 15	(\$1,266,800.14)
Years	15
ROI on FV of Tangible Book Value using BV multiplier in year 15	12.12%

Sanity Checks:

P/E in future

FV of Net Profit in 15N	\$30,386
P/E estimate	15.00
Market Cap on above	-\$455,784
Years	15
Current Enterprise Value	\$227,615
ROI in 15N using above	4.73%

Potential Revenue Growth

Current Revenues	\$58,000
Growth Rate of Revenues for 10N	5.00%

Growth Rate of Revenues after 10N through 15N	5.00%
FV of Revenues in 10N	(\$94,476)
FV of Revenues in 15N	\$120,578
FV of Revenues in 15N	\$120,578
Revenue Multiplier based on Al Meyer Rule of Thumb net margins	5
Possible Market Cap year 15	(\$602,889)
Years	15
Current Enterprise Value	\$227,615
ROI in 15N using above	7%

Quick Thoughts:

Management has longevity and apparent integrity and competency. Company appears conservative in their accounting. They expense everything and do not seem to capitalize much at all. Hence when using comps, that needs to be considered. Extremely well capitalized. AAA rated. Certainly thesis can fail if MSFT is disrupted. Huge moat in Windows and all related products. I can't think of a technology company, or any company for that matter where there cash flows can somewhat be predicted in a conservative manner. Other than tax rate changes, I really don't see any areas for quality of earnings issues. Share buybacks could blossom. Dividend has been increasing and payout ratio for quarter was under 31%. ROE is in 30's.

Two Minute Drill:

Company is a leader in IT. They cover gaming, entertainment, online, all business applications and advertising. Spend a lot on R&D. Because of current valuation, you could have mid teen annualized ROI. Especially since company is AAA and really has no economic climate risk. Has inherent technological disruption risk. I would rate that risk low. Company continues to grow. All fundamentals appear solid. No apparent possibility of permanent loss of capital. I have studied this company for several years, and management appears consistent and does not appear to over-promise under deliver. I feel there is a terrific margin of safety. Interestingly enough, if they do bring on debt to say 25% of equity, Wall Street in her demented mind might place a higher valuation because of "properly deployed capital." No interest rate exposure apparent. Hopefully no false certainties in my analysis. Tier 1 company, and I believe I used ultra conservative growth assumptions.

Something to watch is the potential for the stock to get frothy. We are using some conservative growth estimates. These could turn out to be too optimistic. Our past assumptions are way too optimistic. Yet, eps was not out of line. See AAI folder

2005. Shares repurchased have allowed less earnings and revenues to keep similar eps. Interesting. Look at Intrinsic Value Spreadsheet, and valuation is not as rosey.

Company	Microsoft
Report Date	10-Nov-09
Price	29.01
Growth Rate	7.50%
Price/Sales	4.49
Price/ Net Cash Flow	18.84
Price/ Net Book Value	9.67
P/E Ratio Current	18.13
P/E Ratio Year 2	16.12
Current Ratio	1.82
Quick Ratio	1.80
LT Debt / Shr. Equity	9.47%
LT Debt / Current Assets	7.60%
Return on Shr. Equity	36.83%
PEG Ratio (Current)	2.42
PEG Ratio Year 2	2.15
PEGY Ratio (Current)	1.91
PEGY Ratio Year 2	1.70
Graham Ratio (current)	175.33
Graham Ratio Year 2	155.85
Growth Flow Ratio (s/b <12=nrml)	11.16
Cash King (s/b > 10 %)	23.84%
Flow Ratio (s/b < 1.25)	0.71
Intrinsic Value (current)	27.57
Intrinsic Value Year 2	31.02
Intrinsic Value Year 3	33.35
Intrinsic Value Year 4	35.85
Intrinsic Value Year 5	38.54
Intrinsic Value / Price (current)	-4.95%
Intrinsic Value / Price Year 2	6.93%
Intrinsic Value / Price Year 3	14.95%
Intrinsic Value / Price Year 4	23.57%
Intrinsic Value / Price Year 5	32.84%

If I change growth rate to 10%. We get the following:

Company	Microsoft
Report Date	10-Nov-09
Price	29.01
Growth Rate	10.00%
Price/Sales	4.49
Price/ Net Cash Flow	18.84
Price/ Net Book Value	9.67
P/E Ratio Current	18.13
P/E Ratio Year 2	16.12
Current Ratio	1.82
Quick Ratio	1.80
LT Debt / Shr. Equity	9.47%
LT Debt / Current Assets	7.60%
Return on Shr. Equity	36.83%
PEG Ratio (Current)	1.81
PEG Ratio Year 2	1.61
PEGY Ratio (Current)	1.51
PEGY Ratio Year 2	1.34
Graham Ratio (current)	175.33
Graham Ratio Year 2	155.85
Growth Flow Ratio (s/b <12=nrml)	11.16
Cash King (s/b > 10 %)	23.84%
Flow Ratio (s/b < 1.25)	0.71
Intrinsic Value (current)	33.44
Intrinsic Value Year 2	37.62
Intrinsic Value Year 3	41.38
Intrinsic Value Year 4	45.52
Intrinsic Value Year 5	50.07
Intrinsic Value / Price (current)	15.27%
Intrinsic Value / Price Year 2	29.68%
Intrinsic Value / Price Year 3	42.65%

Intrinsic Value / Price Year 4	56.91%
Intrinsic Value / Price Year 5	72.60%

January 28, 2009 (18.04)

Microsoft reported 2nd qtr (12/31) eps of .47 vs. an estimate of .49. Revenue was also short of estimates by \$.5B. The company also said they were unable to (wouldn't) be providing earnings guidance going forward. Not providing guidance is not a concern for us but others were not pleased as Wall St. does not like uncertainty.

The company also announced earnings unexpectedly in the morning rather than in the afternoon as expected.

The company announced layoffs for the first time in its history. Five thousand employees and an equal number of contractors would be let go. The company seemed surprised of the dramatic downturn in the economy and its effect on PC shipments. On the conference call, MSFT mentioned layoffs at clients may impact the number of license renewals and the need by corporate customers for new PCs.

I quickly revised our intrinsic schedule for 2009 assuming 09 earnings of 1.80/share (vs. 2008 of 1.87) and a 7.5% growth rate. Current intrinsic value is \$23/share with a projected year 5 intrinsic value of \$32/share.

Credit Suisse 1/22/09 noted that **"FQ 2 disappoints, but risk/reward is compelling"**. They mentioned disappointing results in client and MBD divisions driven by weakness in PC market. There was a \$301M loss associated with losses in derivatives and foreign currency. They believe the cost controls implemented by the company will result in solid eps growth in 2010. They have revised their 2009 estimates to reflect eps of 1.75/share. They view as **a unique opportunity to invest in one of technology's bellweather companies.**

November 6, 2008 (20.88)

Here are some quick notes from the 10-Q.

1. Part of cash flow went down this quarter because of a one time payment to the IRS of \$3.1B for an examination of the years 2001 - 2003.

2. Earnings in 1Q08 were \$4,373 versus 1Q07 of \$4,289. Had tax rate stayed at 1Q07's rate of 31%, then 1Q08 earnings would have been \$4,134. EPS would have been \$0.45.

3. R&D is 15% of Revenues.

4. Inventories increased 66%. Most of inventory is in finished Goods.
5. Short Term Debt of \$1,975 occurred for the first time.
6. Tangible Equity was \$19,404. This is 58% of total book value. Previous year Tangible equity was \$22,205 or 61% of Total Book Value.
7. Free Cash Flow.

	3 months 9/08	3 months 9/07
CFO	3,370	5,878
Dividends	(998)	(938)
CapEx	(778)	(510)
FCF	1,594	4,430

I think if you added the \$3.1B IRS payment to the 1,594 FCF 1Q08, you would have FCF of 4,694.

8. Common Stock Repurchased for 1Q08 was \$4.5B.

9. Level 2 assets are \$15.2B.

10. Interesting posts on Microsoft Board were:

A. Embedded Computing Observations

<http://boards.fool.com/Message.asp?mid=27143328>

B. Interesting doubts by excellent poster Jonkai

<http://boards.fool.com/Message.asp?mid=27124089>

11. We use comcast business at work. We were just moved over to a Microsoft Exchange Server by Comcast. This is for remote access. The interface is excellent. Use is excellent. I would imagine that MSFT is profiting from this.

12. I looked at Unearned revenue quickly, and all looked okay to me. This was also mentioned on the conference call. I bring this up because Jonkai on other board discussed it, and believes that MSFT is Cookie Jarring revenues.

13. All segments seem to be strong. Growth in Online service and advertising.

Guidance from CC

1. 2Q08 revenue of 17.3 to 17.8B.
2. Full year revenue of 64.9 to \$66.4B.
3. Expects revenue growth to be greater than IT market.
4. Capex to be reduced to about \$3.7B

Quick Thoughts

I think valuation is compelling. Yet, I have thought that for a few years now. I quickly modeled 5% eps growth for 15 years, using a terminal value of 2X book in year 15, and come up with mid teen ROI's.

Management has longevity and apparent integrity and competency. I trust that MSFT is more knowledgeable on YHOO situation than me and all the analysts. Company appears conservative in their accounting. They expense everything and do not seem to capitalize much at all. Hence when using comps, that needs to be considered. Extremely well capitalized. AAA rated. Certainly thesis can fail if MSFT is disrupted by GOOG, AAPL or any open source vendor , company or cloud. Huge moat in Windows and all related products. I can't think of a technology company, or any company for that matter where there cash flows can somewhat be predicted in a conservative manner. Other than tax rate changes, I really don't see any areas for quality of earnings issues. Share buybacks could blossom. Unearned revenues, although a concern, will turn into higher stockholder equity when realized. Hopefully there will be continued replacement of Unearned Revenue. Is it wrong to look at this in a manner similar to insurance company float? Forward P/E is less than 10. I see yahoo computes a PEG of around 1. I need to verify when I analyse this. Insiders own 13% and institutions own 60%. Dividend has been increasing and payout ratio for quarter was 27%. ROE looks like it could over 40% this fiscal year.

Two minute drill

Company is a leader in IT. They cover gaming, entertainment, online, all business applications and advertising. Spend a lot on R&D. Because of current valuation, you could have mid teen annualized ROI. Especially since company is AAA and really has no economic climate risk. Has inherent technological disruption risk. I would rate that risk low. Company continues to grow. All fundamentals appear solid. No apparent possibility of permanent loss of capital. I have studied this company for several years, and management appears consistent and does not appear to over-promise under deliver. I feel there is a terrific margin of safety. Interestingly enough, if they do bring on debt to say 25% of equity, Wall Street in her demented mind might place a higher valuation because of "properly deployed capital." No interest rate exposure apparent. Hopefully no false certainties in my analysis. Tier 1 company, and I believe I used ultra conservative growth assumptions.

July 18, 2008 (25.54) – down 7.8% today

MSFT released year end earnings (diluted) of 1.87/share vs. 1.42/share last year. (31.6% increase). Revenue for the year was +18.2%. Management guidance for the year end 6/30/09 was lower than what analysts (and what msft had provided last qtr) had expected with revenue of \$67.3B-\$68.1B (+11.4%) and eps of \$2.12-\$2.18 (+13.4%). During the April call, mgt said 09 revenue would be \$66.9B-\$68B and eps of \$2.13-\$2.19.

4th qtr expenses represented 64.1% of revenue while for the year ended 6/30/08 expenses were 62.8% of revenue. Will need to watch and see if this is a trend. Sales and marketing expenses were 24.5% in 4th qtr and 21.6% for the year. In all divisions, company noted increases in headcount as well as related expenses.

Re-ran our valuation worksheet with much more conservative growth rates. Using a 5% earnings growth rate and at 3x tangible book, ROI is 14.5%.

The company still is growing but made references to slowing economy and still comfortable with growth. Questions still about a Yahoo deal. Frustrating for shareholders as msft seems to go back and forth as to whether it wants a deal or not. Goog reported disappointing growth in online advertising and msft noted same—yet there are still talks with yahoo and talk of premiums to yahoo price and Icahn proposals for new yahoo board. This has dragged on for six months and needs to end soon as it appears it is only providing distractions for the company. Blame Steve Ballmer for how much these discussions have been mismanaged.

Will Bill Gates' retirement cause any changes in operations?

February 4, 2008 Revisiting MSFT (30.55)

1. Prepared Valuation analysis, and with a future p/b of 5X in year 15, you would have ROI's annualized of > 18%. Previously we used P/B of 2X, and you still get 15N ROI's of 11.22%. P/E if using 15X gives you ROI of 8%. Everywhere you look, this has buy all over it.
2. Share buy backs are bringing down book value and share price. We look at this as a large positive.
3. Catalysts might include Xbox 360 being stronger than anticipated. This would include accessories and Xbox Live.
4. Zune is being perceived as a formidable competitor, and might be gaining market share. Jobs in an interview during January 2008 was asked about market share growth, and insinuated whomever said that was probably inebriated. Lets see what happens.

5. Margins remain strong.
6. Price to Book value is currently 8.4X, Price to Tangible Book is 13X. Something to watch, but remember MSFT does not capitalize costs, hence book value amongst peers will look understated.
7. We have not reviewed the potential merger of Yahoo.
8. We are currently Modeling 10N growth at 10% and remaining 5N growth at 5%. We are coming up with ROI using 4X BV at terminal 15N of 16+%. Should growth be 5% for next 15N, looks like 13.8% ROI.

December 17, 2005 **Potential Scenario for Discussion Purposes Only**

Again, do your own due diligence! Do not rely on these notes or my discussion in making investment decisions. My analysis is much more in depth, but here is a quick way I put things together.

Investment Thesis:

1. Strong Cash Flow
2. Blue Chip company
3. Heavy insider ownership. Bill Gates owns nearly 10%.
4. Could continue to grow in excess of 10% for a decade. Using rule of 72, if that were to happen, eps would be around \$3.25 in 2015. If you apply a p/e of 15 on that, the company would have a market price of \$48.75. This ignores the growth in cash. If cash continues to grow at \$1B a month for 10 years (ignoring growth rates), then you could add \$120B to market cap. Or \$10 per share. Hence one could argue that MSFT could have a value of \$59 in 10 years. That would be an 8% annual ROI. Add to that the current dividend of 1.34%, you would have an accumulated PV ROI of 9.34%. Again, all this ignores compounded growth of cash, even though we are increasing earnings. The power of compounding would make the ROI much greater.
5. A leader in corporate governance. Keep in mind that Bill Gates is on the Board of Directors of Buffett's Berkshire Hathaway. Gates makes on \$1M annually in salary, and has no options.
6. Accounting Conservatism:

- a. Does not capitalize software development costs. They are allowed to capitalize and they choose to expense immediately.
 - b. Very little stock options given out. They use Restricted Stock Grants sparingly. Dilution is NOT a concern.
 - c. SEC in 2002 (I think that was the year), made them put “tax benefit of stock options” in the operating section of Statement of Cash Flows, rather than financing section. This increased their presentation of operating cash flow. FAS 123R has adopted MSFT old presentation and this item will now go in Financing Section for all companies.
- 7. Strong financial position is an understatement.
 - 8. Strong product pipeline.
 - 9. Regulatory and Linux concerns possibly overblown (see notes below).
 - 10. XBRL

Investment Risks:

- 1. Worldwide Piracy
- 2. Linux
- 3. email complacency (Outlook)
- 4. failed offerings
- 5. Google
- 6. Regulation
- 7. Inherent Industry Technological Disruption

Possible Scenarios:

Quick Projection for Discussion purposes only!!!

Microsoft Corporation
Quick Projection for Discussion purposes only
16-Dec-05

	Actual	Estimate	Estimate	Estimate
	2005	2006	2007	2008
Revenues	\$39,788	\$44,762	\$50,357	\$55,357
Cost of Revenues	<u>(\$5,945)</u>	<u>(\$6,714)</u>	<u>(\$7,554)</u>	<u>(\$8,400)</u>
Gross Profit	\$33,843	\$38,047	\$42,803	\$46,957
Operating Expenses:				
Research and Development	(\$4,953)	(\$7,162)	(\$8,057)	(\$9,000)
Sales and Marketing	(\$8,025)	(\$9,400)	(\$10,575)	(\$11,500)
General and Administrative	(\$1,776)	(\$2,596)	(\$2,921)	(\$3,250)
Total Operating Expenses	(\$14,754)	(\$19,158)	(\$21,553)	(\$23,750)
Operating Income	\$19,089	\$18,889	\$21,251	\$23,207
Other Income	\$2,067	\$1,500	\$1,500	\$1,500
Pre Tax Income	\$21,156	\$20,389	\$22,751	\$24,707
Income Tax	(\$6,982)	(\$7,136)	(\$7,963)	(\$8,400)
Net Income	\$14,174	\$13,253	\$14,788	\$16,307
GAAP Adjustments (extraordinary, stock comp, etc)	(\$1,920)	\$0	\$0	\$0
Net Income (GAAP)	\$12,254	\$13,253	\$14,788	\$16,307
earnings per share (GAAP)	\$1.12	\$1.25	\$1.40	\$1.50

Assumptions:

Revenue Growth Rates	12.50%	12.50%	12.50%
Gross Profit	15%	15%	15%
Tax Rate	35%	35%	35%
Research and Development	16%	16%	16%

Sales and Marketing		21%	21%
General and Administrative		6%	6%

EPS Growth Rates		12.50%	12.50%	1
Shares Fully Diluted	10906	10600	10600	

Valuation Scenario

Current Stock Price		\$27.00	\$27.00	\$
Shares Fully Diluted		10600	10600	
Market Capitalization		\$286,200	\$286,200	\$28
Less: Cash on Hand		-\$40,056	-\$52,056	-\$6
Enterprise Value		\$246,144	\$234,144	\$2
Shares Fully Diluted		10600	10600	
Enterprise Value Per Share		\$23.22	\$22.09	\$
earnings per share (GAAP)		\$1.25	\$1.40	
P/E on EV		18.57	15.83	

December 16, 2005 (26.96)

1. Quarterly dividend raised from \$0.08 to \$0.09 per share. This is a 12.50% increase. Dividend of \$0.36 annually is a rate of 1.34%.
2. some eps estimates

	Date issued	Eps est. June 30, 2006	Eps est. June 30, 2007
JP Morgan	12/15/05	\$1.32	\$1.53
AG Edwards	12/15/05	\$1.33	\$1.57
Garban Equities	12/13/05	\$1.32	\$1.49
Canacord	10/28/05	\$1.31	None

Merrill Lynch	10/28/05	\$1.31	\$1.50
The Buckingham Research	11/30/05	\$1.36	\$1.58
Value Line	11/25/05	\$1.30	13.50% increase

3. largest software company in the world, regulators and legal confrontations are a fact of life.
4. CY 2006 pipeline includes, Xbox 360, Vista and SQL Server 2005. Company has discussed its excitement with growth prospects with this pipeline.
5. Cash on hand is \$40b. Free Cash flow is over \$1B per month.
6. Merrill in 12/15/05 report mentions that MSFT has plenty of room to expand dividend. They cite a potential yield of 3.9%, which turns out to be a \$1.05 annual dividend. In a report a few days earlier, Merrill discussed the synergies and possibilities of AOL and MSFT alliance. They discussed threats to Google. They cited MSFT strong advertising growth at MSN.
7. Garban has a sell rating and mentions that Japan Xbox introduction was weak.
8. I spoke with Fred Hickey of "The High-Tech Strategist" today. He mentioned that Xbox sales are fine, yet supply is constrained and delayed. He fears that an early 2006 roll-out of Sony Play Station 3 would hurt Microsoft. He also mentioned that the legal threats to MSFT are not severe. He mentioned that Xbox has not been breaking down as several reports have indicated.
9. I have read on the net, but have not verified, that EA games CEO has mentioned that PS3 will be delayed to fall of 2006. If this is accurate Xbox could have a huge head start. I need to review Xbox Live. I have read the Xbox works great with Ipod, Xbox live awesome, free unlimited phone calls with premium system (extra \$99), games are better than on pc, this is a first. This is only 1st generation games, supposedly 2nd generation will be blow away excellent.
10. On December 1, MSFT announced a free online classified service to be rolled out. Expected to be competitor of Craigslist (partially owned by ebay).
11. Risks include Linux, regulatory environment and Google.
12. Supposed heart of .Net is to be released in 2006. This includes Visual Studio 2005, SQL Server 2005 and BizTalk Server 2006.

13. buy backs have been heavy. These are happening without option dilution.
14. MSFT spoke a few days ago at NASDAQ 16th Investor Program Conference. Here are some highlights.
 - a. expects 2006 revenue growth to be 10 – 12%.
 - b. Continued strong cash flow
 - c. Continued share purchases and dividends.
 - d. Plans on buying back another \$19B of common stock over next 5 quarters.
 - e. Strongest product pipeline ever
 - f. Expects to sell 2.75m to 3.0M Xbox units in next 90 days. 4.5M to 5.5M units in 2006.
 - g. Excited about Windows Mobile and Office 12.
 - h. Thinks Office 12 will be a program that will encourage upgrades. Older office products did not offer necessary enhancements.
 - i. MSN has over 120M users. Hotmail has over 205M active accounts.
 - j. Expect to see similar eps and revenue growth patterns in the future as you have in the past.
 - k. 2006 is shaping up as year of investments; expect to harvest those investments in future years.
15. Gates owns almost 1B shares, or approx 10% of shares outstanding. He only makes \$1M a year. No options. On BOD of Berkshire Hathaway. Corporate governance appears to be exemplary. Shareholder interests appear to be aligned.

September 29, 2005

Just recently, MSFT has been very focused on eliminating the beauracry they have created, and have started focusing on scientist retention, sales force and google. There were 2 recent write-ups in BusinessWeek.

Rule of Thumb by www.2ndopinionresearch.com

Net Margin	Price to Sales
5%	1X
10%	2X
15%	3X
20%	4X
25%	5X
30%	6X

Revenues F2006E (FYE 6/30) are 44B (value line)

Net operating Margin (E) 31.5

Use P/S of 6 = 264B
 add cash *****40B
 subtract debt***00

potential market value 304B

current price 25

shares o/s 10,250

Market cap 256250

potential discount 16%

Keep in mind that Gates is grabbing 1,002,000 in full compensation (that is a touch over a million a year), and no stock options (poor guy ;-)

September 2, 2005

I'm thinking that most people would probably think that XBRL is a stock on the NASDAQ.

<http://www.xbrl.org/Home/>

" XBRL stands for eXtensible Business Reporting Language. It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. "

My understanding is that XBRL will be huge. As I write this, I'm putting it in the same category as Adobe Acrobat and maybe close to MSFT Word. I have been trying

to figure what companies could benefit from the eventual and what looks to be probable proliferation of XBRL.

I was at an excel seminar this week, and asked the instructor my question on what he thought the beneficiary companies might be. I asked about MSFT. He basically saw no meaningful revenue generation from MSFT in this area. He really couldn't think of any companies. His reason being that it was open sourced software. He then discussed XBRL in the class. We were working with him on laptops. I noticed during the 2 day seminar that his screen in excel had the XBRL tab, whereas mine did not. Most of his excel discussion on XBRL (figure 5% of the total 2 day course) was in display format, since the concept is so new. The teacher explained how XBRL is built into Excel 2003. I have 2000. This is where I had the thought that there could be mass forced purchasing of XBRL capable products. Couldn't this be huge for the MSFT because of all the legacy users, who now want to work with XBRL (talking 2 years from now).

<http://search.microsoft.com/search/results.aspx?st=b&na=88&View=en-us&qu=xbrl>

As i invested in MSFT for the first time this year, XBRL was one of my reasons. MSFT is probably my largest position. I bought MSFT for several reasons and XBRL was hardly at the top of those reasonings. Now, I just think that it could be so much huger than I originally anticipated. any thoughts?

June 22, 2005

1. Gates owns 10.1%, other directors own 4.2%. This is per VL 052705 issue.
2. During May 2005 I read the Q's and 10K. The following are some observations and calculations.

Cash Flow	\$11B
Shares O/S	10.934B
Stockholders Equity	\$47B
Market Cap (\$25 share price)	273B
Eps	1.23
Book Value	4.33

3. What are X-Box expectations. According to VL, home entertainment is 7.8% of revenues.
4. Morningstar on 6/15/05 wrote:
 - a. "one of our favorite tech companies"
 - b. 60% of revenues and majority of its profits come from "two entrenched businesses with wide economic moats." The Windows

- operating system and Office applications. Margins are near 80%, before accounting for restricted stock compensation.
- c. 15% of revenues to R&D. Spent more on R&D than Cisco, Sun Micro and Oracle combined.
 - d. Generates about \$1B per month in cash flow.
 - e. Fair Value estimate of \$30.
 - f. Annual Sales growth of 9% for next 5 years.
 - g. Projects operating profits of 39%.

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